

2017 SPECIAL LEGISLATIVE SESSION

A Report Prepared for the
Joint House Appropriations and Senate Finance and Claims
Committees

By
Legislative Fiscal Division

November 13, 2017



INTRODUCTION

The purpose of this report is to provide Joint House Appropriations and Senate Finance and Claims Committees with a short revenue update, a summary of the executive's general fund balance sheet, and the executive's proposed ideas. In addition, other options available to the legislature are included for consideration. Included in this report are the following:

- Revenues update: FY 2018 year-to-date
- Executive General fund balance sheet
- Executive proposals
- Expanded Call Topics
- Appendix –HJ 2 official general fund balance sheet

YEAR TO DATE REVENUE UPDATE

Highlights of year-to-date general fund revenue collections through October FY 2018 include:

- Individual income tax withholding growth is 3.7% over the same period last year; Legislative Fiscal Division (LFD) staff will continue to monitor this source closely
- Individual income tax estimated payments show 7% growth from prior year; however, only one full quarterly payment has been booked in the accounting system, and it is too early to draw conclusions
- Corporation income tax estimated payments up nearly 31% over prior year; again, only one full quarterly payment has been booked in the accounting system, and it is too soon to draw conclusions

Information regarding calendar year 2016 base taxpayer income is contained in the state financial quick notes published by the LFD.

GENERAL FUND BALANCE SHEET

The Legislative Fiscal Division regularly publishes a general fund balance sheet during legislative sessions and during the interims for Legislative Finance Committee meetings. The balance sheets include HJ 2 revenues adopted by the legislature and LFD estimates for expenditures. At the October 2017 Legislative Finance Committee meeting, members received an updated general fund balance sheet (in the appendix of this report) showing the general fund ending fund balance with HJ 2 revenue estimates at \$236 million for FY 2019.

The executive general fund balance sheet from August 30, 2017 shows a FY 2019 balance of (\$44) million. The significant areas of difference between the HJ 2 balance sheet and OBPP balance sheet are in the following areas (biennium numbers):

- Executive revenue estimates are \$282 million below HJ 2 revenue estimates; and
- HELP Act Medicaid expenditure estimates are \$9.8 million higher

Please note: In the executive balance sheet, OBPP included a line titled "HB 3 supplementals". The current HB 3 was adopted during the regular 2017 session. OBPP was referring to a potential HB 3 special session version in their August balance sheet. Since the fire fund transfer is a portion of the executive proposal the following presentation includes it in the table of executive proposals.

EXECUTIVE PROPOSED GENERAL FUND BALANCE SHEET

The following balance sheet shows the executive balance sheet with ending fund balance of (\$44) million in FY 2019 without special session reductions or transfers to the fire fund.

Executive General Fund Balance Sheet - August 30, 2017				
(\$ Millions)				
11/13/2017 11:55 AM				
	Actual FY 2016	Actual FY 2017	Estimated FY 2018	Estimated FY 2019
Beginning Fund Balance	\$455.436	\$256.478	\$47.564	(\$15.576)
Revenues				
Actual/HJ 2 Estimates (adjusted for legislation)	2,121.288	2,141.479	\$2,402.334	\$2,482.396
Actual/Executive Revenue Estimate Difference from HJ 2 (adjusted for legislation)			(137.428)	(144.516)
Other Revenue	(3.667)	8.608		
Total Revenue Funds Available	2,573.057	2,406.565	2,312.470	2,322.304
<u>Expenditures - Executive Estimates</u>				
Statutory Appropriations (Actual/Executive Estimates)	265.168	291.065	325.531	313.825
General Fund Transfers	29.254	20.668	20.108	20.693
HB 2 Disbursements (Actual/Executive Estimates)	1,908.415	1,957.389	1,986.310	2,033.305
HB 1 (executive estimates)	5.025	8.239	2.210	9.063
HB 3 Supplementals			-	-
Other Appropriations		3.417	1.661	(2.349)
Reversions (calculated)			(7.774)	(7.902)
Ongoing Expenditures	2,207.861	2,280.778	2,328.046	2,366.635
OTO				
HB 2	64.519	47.618		
Other	51.456	36.341		
Special Session Executive Expenditure Reductions				
Total Expenditures	<u>2,323.836</u>	<u>2,364.737</u>		
Adjustments - Prior Year		(4.058)		
Other adjustments	5.888	(1.678)		
CAFR Adjustments	1.368			
Ending Fund Balance	\$256.478	\$47.564	(\$15.576)	(\$44.332)

EXECUTIVE PROPOSALS

The following table displays the executive's proposals that increase the executive's ending fund balance from (\$44) million to \$143 million in FY 2019.

Executive Proposals for Executive Balance Sheet November 2017		
Executive Revenue Proposals	Est. FY 2018	Est. FY 2019
<i>Proposed Tax Increases</i>		
SB 4 <i>Authorize management fee on excess investment holdings of State Fund</i>	14.648	15.084
SB 5 <i>Revising the sale of new liquor licenses by requiring an auction of new licenses</i>		2.488
SB 6 <i>Temporarily Increase Accommodations/Rental Car Tax Rates</i>	12.773	32.624
<i>Proposed Transfers Into General Fund from Other Sources</i>		
HB 1 <i>Big Sky Economic Development fund 90-1-205</i>	0.210	
HB 1 <i>Capital Complex Maintenance</i>	2.000	
HB 1 <i>Secretary of State enterprise fund 2-15-405</i>	0.410	0.400
HB 1 <i>State Auditor 33-2-708, 33-28-120, 30-10-115</i>	0.580	0.538
HB 1 <i>Public Service Commission fund - 69-1-402</i>	0.277	0.248
HB 1 <i>Highway nonrestricted account - Aug 1, 2018 - 15-70-125</i>		4.000
HB 1 <i>Highway nonrestricted account - June 30, 2019 - 15-70-125</i>		4.000
Dept. of Administration SABHRS Transfer from Proprietary	0.200	0.300
Public Sale of Abandoned Property - Securities before 3 yrs		3.870
Executive Revenue Proposal Totals	31.098	63.552
Executive Expenditure Proposals		
17-7-140 <i>Executive Proposed Expenditure Reductions</i>	(32.585)	(44.055)
<i>Executive Proposed State Information Technology Rate Reduction</i>	(1.200)	(1.200)
<i>Executive Proposed Expenditure Legislation</i>		
HB 1 <i>School Facility and Technology - offset approp</i>	(3.400)	(4.800)
HB 3 <i>Transfer Funds from General Fund to the Fire Suppression Account</i>	40.000	
HB 4 <i>Revise state fire assessment to apply to all parcels. Reduces DNRC appropriation</i>		(13.000)
SB 1 <i>Temporarily suspend employer contributions to judges' retirement system</i>	(0.900)	(1.800)
SB 2 <i>Eliminate K-12 transportation and combined block grant payments</i>		(11.656)
SB 3 <i>Providing a two month state employer contributions holiday</i>	(10.470)	
LC0010 <i>Suspend the coal fired generating unit payment for the current biennium</i>	(1.694)	(1.694)
Need legislation <i>Legislative Branch</i>	(0.774)	(0.774)
Need legislation <i>Judicial Branch</i>	(1.805)	(1.885)
Executive Expenditure Proposal Totals	(12.828)	(80.864)
Exec Adjustments	(0.470)	(0.335)
Ending Fund Balance with Executive Revenues and Executive Proposals	\$27.880	\$143.206

Tax Increases

Increasing taxes on the proposed items is estimated to increase general fund revenue by \$75.1 million for the 2019 biennium. The executive proposed tax increases for deposit into the general fund are the following:

- [SB 4](#) proposes a management fee on excess investment holdings of State Fund
- [SB 6](#) Lodging sales tax: A proposed lodging sales tax increase from 3% to 6% implemented January 1, 2018, could potentially impact revenues by \$11.9 million in FY 2018, \$25.2 million in FY 2019 and \$13.1 million in FY 2020
- [SB 6](#) Rental car sales tax: A proposed rental car sales tax increase from 4% to 10% implemented January 1, 2018, could potentially impact revenues by \$3.3 million in FY 2018, \$6.8 million in FY 2019 and \$3.7 million in FY 2020

In addition, the executive proposed [HB 4](#) revises the state fire assessment to apply to all parcels. This proposal expands the assessment fee paid by landowners within a wildland fire protection district and applies the assessment fee to all parcels. The expansion provides \$13.0 million in state special revenue and reduces the Department of Natural Resource and Conservation general fund expenditures by the same amount.

General Fund Revenue from Fund Balance Transfers

The executive proposes to transfer funds from other state resources into the general fund providing up to \$13.2 million in one-time general fund revenue. The following fund balance transfers are proposed:

- Department of Commerce – Big Sky Economic Development, \$210,000 for the biennium, [HB 1](#)
- Department of Administration – Capital Complex Maintenance, \$2.0 million for the biennium, [HB 1](#)
- Department of Administration proprietary funding for the Statewide Accounting, Budgeting and Human Resources System (SABHRS), \$500,000 for the biennium
- Secretary of State – Enterprise Fund, \$810,000 for the biennium, [HB 1](#)
- State Auditor – three funds (33-2-70; 33-28-120; 30-10-115, MCA), \$1.1 million for the biennium, [HB 1](#)
- Public Service Commission Fund, \$525,000 for the biennium, [HB 1](#)
- Montana Department of Transportation – Highway non-restricted fund, \$8.0 million for the biennium, [HB 1](#)

The transfer of fund balances may result in reductions in spending. The executive does not have the authority to reduce expenditures for elected officials like the Secretary of State, State Auditor, or the Public Service Commission but a reduction of fund balances may achieve the same result.

Transfer to Wildfire Suppression Fund

[HB 3](#) as proposed by the executive transfers \$40.0 million in FY 2018 from the general fund to the wildfire suppression fund.

General Fund Revenue from Sale or Auction

Unclaimed Property Sale

The executive proposes selling unclaimed property, specifically unclaimed securities currently held by the state. If the Department of Revenue (DOR) holds a security for over three years they have the ability to sell it without having to repay any additional appreciation if the rightful owner claims the property, however if they sell it within the three year window, DOR is responsible for any additional appreciation the security may have acquired. By selling unclaimed securities during the three year window, it is estimated that this will generate an additional \$3.7 million into the general fund for the 2019 biennium.

Auction of New Alcoholic Beverage Licenses

Montana law currently limits the number of licenses for the sale and on premise consumption of alcoholic beverages through a quota system based on population. If enough growth in the population of a quota area (usually an incorporated city) takes place, a license may come available in the area. Often when a license comes available there are several parties interested in acquiring a license in which case a lottery is held for the right to acquire the license. The executive proposes to suspend the lottery and instead require an auction of new licenses potentially providing \$2.5 million in general fund revenue.

Expenditure Reductions

17-7-140 Executive Proposals for General Fund Reductions

The most significant executive proposal for expenditure reductions totals \$76.6 million. The calculation of the reduction percentage is not specifically defined in statute, so sometimes different interpretations of how the percent calculation is made. The executive's -6.61% is the average of the agency's individual reductions, without taking into consideration the size of the agencies' budgets. The LFD reduction is simply the total amount of proposed reductions divided by the total original appropriated budget.

Executive Proposed Spending Reductions By Agency General Fund 2019 Biennium			
Agency	2019 Biennium General Fund*	Reduction	% Reduction
Section A - General Government			
Governors' Office	\$12,907,450	(\$853,728)	-6.61%
Commissioner of Political Practices	1,524,131	(152,414)	-10.00%
Department of Revenue	105,641,482	(2,931,493)	-2.77%
Department of Administration	14,593,236	(1,140,556)	-7.82%
Department of Commerce	7,255,023	(725,503)	-10.00%
Department of Labor and Industry	3,581,426	(358,270)	-10.00%
Department of Military Affairs	<u>13,063,876</u>	<u>(948,618)</u>	<u>-7.26%</u>
Subtotal Section A	158,566,624	(7,110,582)	-4.48%
Section B - Health and Human Services			
Department of Public Health and Human Services	<u>1,050,308,010</u>	<u>(49,213,957)</u>	<u>-4.69%</u>
Subtotal Section B	1,050,308,010	(49,213,957)	-4.69%
Section C - Natural Resources and Transportation			
Department of Environmental Quality	10,389,343	(1,038,935)	-10.00%
Department of Livestock	5,114,148	(511,416)	-10.00%
Department of Natural Resources & Conservation	54,339,812	(2,928,417)	-5.39%
Department of Agriculture	<u>1,520,586</u>	<u>(152,058)</u>	<u>-10.00%</u>
Subtotal Section C	71,363,889	(4,630,826)	-6.49%
Section D - Judicial Branch, Law Enforcement, and Justice			
Crime Control Division	4,619,158	(461,916)	-10.00%
Department of Justice	68,542,177	(4,533,205)	-6.61%
Office of the Public Defender	64,715,899	0	0.00%
Department of Corrections	<u>402,028,523</u>	<u>(4,436,926)</u>	<u>-1.10%</u>
Subtotal Section D	539,905,757	(9,432,047)	-1.75%
Section E - Education			
Office of Public Instruction	81,187,773	(1,612,042)	-1.99%
Board of Public Education	298,995	(29,900)	-10.00%
Office of the Commissioner of Higher Education	447,281,893	(4,472,819)	-1.00%
Montana Arts Council	1,056,627	(105,663)	-10.00%
Montana State Library	4,418,824	0	0.00%
Montana Historical Society	<u>5,360,705</u>	<u>0</u>	<u>0.00%</u>
Subtotal Section E	539,604,817	(6,220,424)	-1.15%
Grand Total (including elected official budgets)	\$2,359,749,097	(\$76,607,836)	-3.25%
* SB 294 appropriations for pay plan increases, and SB 261, workers' compensation appropriation reductions included.			
% of total Executive Branch Agencies (no elected official budgets)	2,197,111,697	(69,608,861)	-3.17%
Executive Calculated Average of Agency Percentages			-6.61%

The Executive Branch may not reduce non-executive branch agency expenditures. The executive suggested that the Legislative and Judicial branch reduce expenditures totaling \$5.2 million for the biennium. The Judicial Branch provided a [memorandum](#) to the executive outlining possible reductions.

Other Executive Proposed Reductions

The executive proposed additional reductions that further impact general fund expenditures:

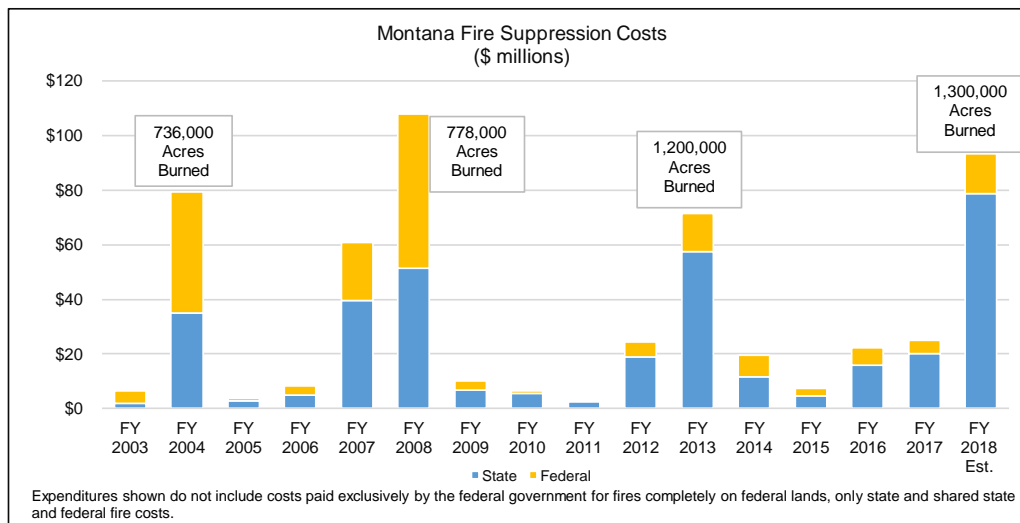
- [HB 1](#) provides for a transfer from the school facility and technology state special revenue fund of \$8.2 million for the biennium to the [guarantee fund](#). The guarantee fund is a state special revenue fund dedicated to K-12 education funding. Guarantee funding reduces the need for general fund, and therefore this proposal would lower Office of Public Instruction general fund appropriations for K-12 education
- Leverage fund balances for the following:
 - [SB 1](#) temporarily suspends the state employer contribution to the judges' retirement system (JRS). This executive proposal stops the payment of the employer contribution into the judges' retirement system beginning January 1, 2018 and terminating June 30, 2019. This potentially saves \$2.8 million in general fund. As of the June 30, 2017 actuarial valuation JRS was 167% funded, meaning contributions and investment earnings are projected to be 67% greater than projected benefit obligations
 - [SB 3](#) State benefit employer payment holiday – the state of Montana provides health benefits to eligible state employees through a self-insured plan. The executive proposes to stop payments of the employer contributions into the plan for two months. This potentially saves \$10.5 million in general fund. The self-insured plan (SEGBP) is required to maintain reserves to ensure that funding is available for the health costs submitted in subsequent years. Depending on actual medical and pharmacy cost trends, reductions in the current SEGBP fund balance may result in state employer and/or employee contribution increases sooner than would have otherwise occurred
- [SB 2](#) and [LC0010](#) revise school funding block grants and reimbursements, plus suspend payment of coal fired generating unit block grants. SB 2 eliminates the combined block grants that the state provides to school districts and LC0010 eliminates the coal fired generating unit mitigation payment. These executive proposals would potentially save the state \$15.0 million in general fund for the 2019 biennium
- Lower the rates agencies pay to the State Information Technology Services Division for computer related services. The rate reduction potentially saves \$2.4 million in general fund for the 2019 biennium

This concludes the analysis section of the executive proposals.

OTHER STATE FINANCIAL ITEMS

Wildfire Suppression

The summer of 2017 is likely to be the most expensive state fire year in Montana's history with a current estimated state liability of \$78.8 million. By the end of September, when changes in weather patterns aided in the control of most fires, total acres burned in the first few months of FY 2018 was estimated at about 1.3 million. The chart shows a history of state and federal expenditures since FY 2003.



Montana's Responsibility for Fire Suppression Costs

Estimated obligations as of October 26, 2017, exceeded the balance of the fire fund and the Governor's statutory emergency fund appropriation, resulting in a shortfall in appropriations of \$34 million in FY 2018. While the costs exceed appropriation authority, the Department of Natural Resource and Conservation (DNRC) has the ability to cash flow high cost fire years, as there is a delay between firefighting activities and actual payments. However even with the cash flow ability, it is unlikely that expenses for firefighting activities will be paid by the DNRC without legislative intervention prior to the 2019 regular session.

Two potential legislative actions could resolve the shortfall:

1. Increase the general fund appropriation to DNRC and/or Military Affairs
2. Increase the cash balance in the fire suppression fund through transfers or new revenue sources

Both solutions require legislative action to accomplish. Although the first may increase pressure on the general fund balance, the second solution removes financial pressure on the general fund.

The chart below shows the anticipated costs, the appropriation authority authorized by the 2017 Legislature, and the appropriation shortfall.

Estimated Fire Suppression Costs 2019 Biennium (\$ millions)			
<u>Expenditures</u>	<u>FY 2018</u>	<u>FY 2019</u>	<u>Biennium</u>
Fire Cost (10/26/17) with updated FEMA	\$71.3	\$0.0	\$71.3
Estimated reimbursement to Dept. of Military Affairs	7.0	0.0	7.0
Additional Estimated Fire Cost	0.5	22.5	23.0
Total Expenditures	\$78.8	\$22.5	\$101.3
<u>Appropriations</u>			
Fire Fund Statutory Appropriation (02847)	\$32.3	\$0.0	\$32.3
Governor's Emergency Fund ¹ For Fires	12.5	0.0	12.5
Total Funding	\$44.8	\$0.0	\$44.8
Appropriation Shortfall	(\$34.0)	(\$22.5)	(\$56.5)
Biennial Appropriation Shortfall			
¹ Emergency statutory appropriation is \$16.0 million. Based on information provided by the Governor's office to the Legislative Finance Committee in October 2017, it is assumed \$12.5 million will be for fires in FY 2018. This would leave a balance of \$3.5 million for other emergencies.			

Funding the Wildfire Suppression Fund

A fire fund reduces the financial stress on the general fund. When fire fund balance is spent, as it is today, the general fund is the only funding source available unless the legislature finds alternatives. In past years certain revenues were dedicated to the wildfire suppression fund.

Historical Fire Suppression Information

During the 2007 Special Session, the legislature created a fire suppression fund to help address the risk associated with the variable nature of wildfires and associated costs. This fund is statutorily appropriated to the Department of Natural Resources and Conservation for fighting fires, and gives the State of Montana more flexibility in paying for them.

Since the legislature has the constitutional authority and responsibility for establishing a budget, the executive branch of government must operate within the parameters of this budget. When expenditures create a misalignment, the executive does have some options for managing the overall budget. In the case of the fire suppression fund, the executive can augment this with the \$16 million emergency fund appropriation and potentially transfer other authority as well. However, the executive cannot expand the overall appropriation authority authorized by the legislature.

EXPANDED CALL ITEMS

Insurance Taxes – Expand to All Companies

If the current tax rate of 2.75% of net premiums on policies sold by most for-profit companies is expanded to all companies, including Montana State Fund, the potential revenue impact on general fund is estimated to be \$19.6 million for the biennium, if implemented on January 1, 2018.

Ending Fund Balance Calculations

A stabilization tool that existed prior to the budget stabilization reserve fund legislation (SB 261, 2017 session) is the 5% trigger threshold (ending fund balance must be at least 5% of second year general fund appropriations or expenditure reductions must be made). This trigger was increased from 2% to 5% in 2015 to work as a budget stabilization tool and improve credit ratings. Budget stabilization tools, like both the trigger and the budget stabilization reserve fund, are intended to give a cushion to state budgets so drastic tax or expenditure policy changes are not needed in the event of fiscal pressures.

An option for addressing the state's current budget concerns could be to reduce this trigger threshold from 5% back to the pre-2015 level of 2% in order to alleviate the most severe expenditure reductions being considered.

CoreCivic

A proposed re-negotiation of the Department of Correction's contract with CoreCivic (the private operator of the correctional facility in Shelby) would return approximately \$30 million the state has already paid toward the potential purchase of the facility at contract term in 2019, and extend the private contract to 2029.

APPENDIX

HJ 2 BALANCE SHEET (UNADJUSTED)

HJ 2 General Fund Balance Sheet (\$ Millions)				
11/8/2017 12:05 PM				
	Actual FY 2016	Actual FY 2017	Estimated FY 2018	Estimated FY 2019
Beginning Fund Balance	\$455.436	\$256.478	\$47.564	\$130.754
Revenues				
Actual/HJ 2	2,121.288	2,141.479	2,359.345	2,476.395
Ongoing Revenue			0.929	0.011
OTO Revenue	(3.667)	8.608	42.061	5.991
Special Session				
Total Revenue Funds Available	2,573.057	2,406.565	2,449.898	2,613.150
Expenditures - Ongoing				
Statutory Appropriations (LFD estimates as of August 2017)	265.168	291.065	313.040	324.592
General Fund Transfers (LFD estimates as of August 2017)	29.254	20.668	20.108	20.693
HB 2				
HB 2 Language Appropriations			0.050	0.050
HB 2 Agency Budgets	1,908.415	1,957.389	1,991.208	2,042.472
HB 2 SB 261 Reductions			(19.987)	(25.923)
Non HB 2 - Other appropriations, etc.				
HB 1	5.025	8.239	2.390	10.368
Other Appropriations		3.417	6.273	0.281
Reversions			(6.999)	(7.195)
Ongoing Expenditures	2,207.861	2,280.778	2,326.070	2,391.261
OTO				
HB 2	64.519	47.618	15.158	14.393
Other	51.456	36.341	(2.097)	(2.625)
Executive Expenditure Reductions				
Total Expenditures	2,323.836	2,364.737	2,319.145	2,377.106
Adjustments - Prior Year		(4.058)		
Other adjustments	5.888	(1.678)		
CAFR Adjustments	1.368			
Ending Fund Balance	\$256.478	\$47.564	\$130.754	\$236.044
Structural Balance (ongoing revenues minus ongoing expenditures)	(\$86.573)	(\$139.299)	\$34.204	\$85.145